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February 19, 2008

AGENDA ITEM 7a

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. SUBJECT:** Inflation-Linked Asset Class – Update on Implementation
- II. PROGRAM:** Total Fund
- III. RECOMMENDATION:** Information
- IV. ANALYSIS:**

BACKGROUND

The purpose of this item is to provide a monthly update to the Investment Committee on the progress of the implementation of the Inflation-Linked Asset Class (ILAC). The ILAC was approved as a pilot program in September 2007. In December 2007 ILAC was approved as a regular asset class and included in the Strategic Policy Allocation with a target of 5% and range of 0% to 5%. The Investment Committee has required that a number of steps need to be in place before proceeding with new investments in ILAC.

INVESTMENT POLICIES

Policies for the ILAC and three of its four components (Commodities, Inflation-Linked Bonds, and Forestland) were submitted to the Policy Subcommittee in December 2007. These policies will be presented for approval by the Investment Committee in February 2008 with changes required by the Investment Policy Subcommittee. The Infrastructure policy was targeted for the Policy Subcommittee in February 2008, but has been deferred to the next Policy Subcommittee meeting due to ongoing discussions with constituent groups.

ORGANIZATION

As outlined in the November 13, 2007 agenda item 4b (Attachments 1 & 2), the Inflation-Linked Asset Class (ILAC) will be managed by the Senior Investment Officer-Asset Allocation/Risk Management (SIO-AA), within the Investment Office Asset Allocation and Risk Management Unit. The ILAC group will be one of three groups within the Unit. This structure and the related staffing are reflected on the attached organization chart (Attachment 3). (The current organization chart is shown on Attachment 4).

The SIO-AA will have the responsibility for the ILAC and its four components (Commodities, Inflation-Linked Bonds, Infrastructure, and Forestland) in terms of allocations, performance and compliance with approved ILAC policy. Commodities will report directly to the SIO-AA. Inflation-Linked Bonds portfolio will be managed within Global Fixed Income (GFI) on a day-to-day basis on behalf of the ILAC in a "client-manager" relationship. ILAC is the client and GFI is the manager. The SIO-AA and SIO-GFI have agreed upon a process for this relationship. Infrastructure and Forestland will report directly to the SIO-AA once the positions are staffed. Until then existing investments in Infrastructure and Forestland will be managed within the Alternative Investments Management Unit and the Real Estate Unit where these investments originated. Once core staff is hired for Infrastructure and Forestland the responsibility for existing investments and new investments will transfer to the Asset Allocation Unit. This is expected to take place on or before July 1, 2008. We will inform the Investment Committee when this transition occurs.

The specific positions being used to staff the ILAC group are as follows:

Commodities: One Portfolio Manager position. This position has been transferred from the GFI Unit. This position was established effective in July 2007 to staff the Commodities pilot program previously housed in the GFI Unit.

Infrastructure and Forestland: One Senior Portfolio Manager (SPM), one Portfolio Manager (PM), and two Investment Officer positions (IO III, IO II). The SPM and IO III positions have been approved as of January 2008 and the PM position has been approved effective July 2008. One of the Investment Officer positions already exists within the Asset Allocation Unit; and has been redirected to the ILAC group. None of the positions for Infrastructure and Forestland have been redirected from other Investment Office Units. Recruitment for the SPM and IO III positions will commence in February 2008, once a recruitment firm is selected.

Inflation-Linked Bonds: The positions responsible for these investments will continue to reside within the GFI Unit.

DELEGATIONS

The Delegation Resolution for the SIO-Asset Allocation to include ILAC will be presented to the Investment Committee in February 2008.

INCENTIVE PLAN

The performance (incentive) plans for all eligible staff involved in the management of the ILAC with appropriate changes will be presented to the Performance and Compensation Committee in February 2008. The SIO-AA will have a performance target linked to the total return of the ILAC relative to the approved benchmark. The performance plan of the Commodities Portfolio Manager will be linked to the return of the commodities total return relative to the benchmark. Staff involved in the management of the Inflation-Linked Bonds (ILB) portfolio has other duties within the Global Fixed Income Unit; thus their performance plans will be amended to include the performance targets for ILB. Performance plans for Infrastructure and Forestland staff will be submitted once these positions are filled. These plans will be linked to the performance of the respective portfolios relative to those benchmarks.

IMPLEMENTATION

Upon approval of the IL asset class policies and meeting the pre-conditions (organization structure, staffing, incentive plan, delegations) implementation will begin as follows:

Commodities: Current portfolio will be scaled up opportunistically following approval of the policy and delegation.

Inflation-Linked Bonds: Portfolio will begin investing in March 2008 following the approval of the policy and delegation.

Infrastructure: New investments may begin as soon as pre-conditions (staffing, organization structure, delegations, investment plans) are met which is expected to be no later than July 1, 2008. Staff has been reviewing transactions in the interim period to develop a deal log and be ready for implementation.

Forestland: Additional investments may begin as soon as pre-conditions (staffing, organization structure, delegations, investment plans) are met which is expected to be no later than July 1, 2008.

Since private market opportunities have a time window, staff would like to have the flexibility to move forward with any compelling and time-critical opportunities in Infrastructure and Forestland once policies are approved and may bring them to the Committee if needed before July 1.

V. STRATEGIC PLAN:

This item is consistent with Strategic Plan Goal VIII, manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first, to pay benefits, and second, to minimize and stabilize contributions. This item is also consistent with Goal IX; achieve long-term, sustainable, risk-adjusted returns.

VI. RESULTS/COSTS:

This item is not expected to have any material cost impact other than costs associated with managing the ILAC.

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